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TAGS: BTIO ECON EINV EPET ENRG PREL LY
SUBJECT: A SUCCESS?: ENI'S DEAL WITH LIBYA'S NATIONAL OIL CORPORATION

¶1. Summary: Italian energy firm Eni has struck a major deal with Libya's National Oil Corporation that will significantly extend its concession contracts and launch an ambitious series of exploration and development activities. While trumpeted by Eni as a success, the deal carries serious negatives for the company, and may pave the way for the imposition of similar, not altogether positive arrangements with other foreign oil and gas concession holders. End Summary.

¶2. Leading Italian energy firm Eni announced a 25-year extension to its oil and gas contracts with Libya's National Oil Corporation (NOC) October 16. Press reports indicate that some of Eni's most important oil and gas concessions were to expire over the next two years; the new agreement extends all of its concessions until 2042 and 2047, respectively. Eni will invest $14 billion in related infrastructure (a total matched by the NOC for a total of $28 billion). Eni will also expend at least $800 million for additional exploration activities, a sum approaching the mammoth $900 million exploration plan unveiled following British Petroleum's May 2007 deal with the NOC. Eni and NOC will also reportedly embark on a limited program of enhanced oil recovery (EOR) in some of Eni's existing fields.

¶3. The new deal paves the way for a potential doubling of Libya's gas exporting capacity to 16 billion cubic meters (BCM). Eni is Libya's partner for the "Greenstream" gas pipeline, which runs from the Libyan coast to Sicily and which handles its extant gas export capacity. The new contract envisages expanding Greenstream's capacity to 11 billion BCM and constructing a new liquefied-natural-gas (LNG) plant at the Mellita gas export hub with a capacity of BCM a year.

STEEP HIDDEN COSTS

¶4. While cast in most press accounts as a triumph for the Italian firm, the deal also carries substantial costs. Eni officials are reportedly far from enthralled with the new arrangements. The terms of the new agreement take Eni out of a true concession agreement, under which they derived a relatively healthy margin on the product that they lifted (exported) from Libya, and into a production sharing agreement. Under its previous terms, Eni was responsible for tax and royalties on lifted product, but was compensated by the NOC for substantial portions of its exploration and development costs, including well-drilling. Under the new arrangements, which are governed by the general terms of the current round of Exploration and Production Sharing (EPSA IV) agreements, Eni is responsible for all of these costs. Eni thus has a lower cost recovery factor in line with recent concession "winners" (who have won with bids

as low as 7%). The result is that the NOC takes a larger cut of produced oil and Eni books a lower quantity of reserves, negatively affecting the company's share price. On top of this, Eni will reportedly pay a $1 billion bonus to NOC as part of the deal, and has agreed to retire an outstanding $500 million debt to the NOC by year's end.

A WORRYING SIGN OF THINGS TO COME?

¶5. Representatives of international oil companies (IOCs) operating in Libya have expressed grave doubts about the Eni deal. One executive described it as "scary," adding that it raised serious questions about NOC adherence to the sanctity of existing contracts. Post has learned that the NOC has approached several IOCs, including TOTAL (France), Wintershall (German) and Repsol (Spain), to explore renegotiating the terms of their current operations. There is widespread worry among the IOCs that the NOC may expand this effort and open discussions with other concession holders in an effort to extract more favorable terms. The use of the EPSA IV bidding round model of production sharing agreements would most damage companies operating under concession agreements, such as Wintershall. Those agreements were concluded during the sanctions period, when low spot market prices and Libya's limited options resulted in the granting of more favorable terms. The IOCs that have been approached about renegotiating are irked that the NOC is coming after them now, particularly since their companies took substantial risks to do business in Libya when UN sanctions were in place.

¶6. Comment: Post's contacts have expressed acute annoyance with Eni for conceding to the NOC's initiative, particularly given the company's past record of similar behavior. Contacts point to Eni's agreement on a $150 million "social development

package" with the NOC in September 2006 as another example of the firm's having given in to pressure from the NOC. With Eni's new deal on the books, the NOC will now have greater leverage to force other companies to conclude similar agreements. At the same time, the quality of parcels offered under the auspices of Libya's latest EPSA rounds has been increasingly marginal in economic terms. The confluence of increasingly difficult hydrocarbon reservoirs and an increasingly avaricious NOC could curb further interest by major IOCs in new EPSA agreements, leading to greater participation by smaller, less capable operators in Libya's oil and gas sector. End comment.
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